

STATE BOARD OF ACCOUNTS
302 West Washington Street
Room E418
INDIANAPOLIS, INDIANA 46204-2765

AUDIT REPORT

OF

INDIANA STATE TEACHERS' RETIREMENT FUND
A COMPONENT UNIT OF THE
STATE OF INDIANA

July 1, 2003 to June 30, 2004



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AGENCY OFFICIALS

<u>Office</u>	<u>Official</u>	<u>Term</u>
Director	Dr. William E. Christopher	01-08-01 to 03-31-05
President of the Board	Mr. Matthew B. Murphy, III	01-07-00 to 11-30-05



STATE OF INDIANA

AN EQUAL OPPORTUNITY EMPLOYER

STATE BOARD OF ACCOUNTS
302 WEST WASHINGTON STREET
ROOM E418
INDIANAPOLIS, INDIANA 46204-2765

Telephone: (317) 232-2513
Fax: (317) 232-4711
Web Site: www.in.gov/sboa

INDEPENDENT AUDITORS' REPORT

TO: THE OFFICIALS OF THE INDIANA STATE TEACHERS'
RETIREMENT FUND BOARD OF TRUSTEES

We have audited the accompanying basic financial statements of the Indiana State Teachers' Retirement Fund as of and for the year ended June 30, 2004. These basic financial statements are the responsibility of the Indiana State Teachers' Retirement Fund Board of Trustees' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The reserves and designations note disclosure for the pension plan administered by the Indiana State Teachers' Retirement Fund Board of Trustees does not disclose the balances of the legally required reserves or their funding status as of June 30, 2004. In our opinion, disclosure of this information is required by accounting principles generally accepted in the United States of America.

In our opinion, except for the omission of the information discussed in the preceding paragraph, the basic financial statements referred to above present fairly, in all material respects, the plan net assets of the fiduciary funds of the Indiana State Teachers' Retirement Fund Board of Trustees as of June 30, 2004, and the changes in the plan net assets of the fiduciary funds for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis, Schedule of Funding Progress, Schedule of Employer Contributions, and the Notes to Required Supplemental Schedules are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of required supplementary information. However, we did not audit the information and express no opinion on it.

STATE BOARD OF ACCOUNTS

October 26, 2004

MANAGEMENT'S DISCUSSION & ANALYSIS

This section presents management's discussion and analysis of the Indiana State Teachers' Retirement Fund (TRF) financial statements for the year ended June 30, 2004. The MD&A is presented as a narrative overview and analysis in conjunction with the Letter of Transmittal included in the TRF Annual Financial Report. The MD&A should also be read in conjunction with the financial statements, the notes to the financial statements, and the supplementary information.

FINANCIAL HIGHLIGHTS

- The net assets of TRF were \$6.8 billion as of June 30, 2004.
-
- The net assets of TRF increased by \$603 million, or 9.9% from the prior year. The increase was primarily due to positive total returns on Fund investments, resulting in higher investment values.
-
- The TRF rate of return on investments for the year was positive 11.8% on a market value basis, compared to last year's positive 6.2%, due primarily to the strong performance in the world equity markets during the first six months of the fiscal year.
-
- As of June 30, 2003, the date of the most recent actuarial valuation, the Pre-96 plan(Closed Plan) is actuarially funded at 42.9%, which is more than the 41.2% funded level as of June 30, 2002. The 96 plan(New Plan) is actuarially funded at 59.3%, which is more than the 53.2% funded level as of June 30, 2002. The closed plan includes all members who were hired before July 1, 1995 and have been continuously employed by the same board of education as they were on that date. The new plan includes all other members.
-

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to TRF's financial statements. The financial section of the TRF Annual Financial Report is comprised of three components: 1) TRF's financial statements, 2) notes to the financial statements, 3) required supplementary information. The information available in each of these sections is briefly summarized as follows:

1) Financial Statements

The statement of plan assets presents information on TRF's assets and liabilities and the resulting net assets held in trust for pension benefits. This statement reflects TRF's investments, at fair value, along with cash and short-term investments, receivables and other assets and liabilities. This statement indicates the net assets available to pay future pension benefits and gives a snapshot at a particular point in time.

The statement of changes in plan net assets presents information showing how TRF's net assets held in trust for pension benefits changed during the years ended June 30, 2004 and 2003. It reflects contributions by members and employers along with deductions for retirement benefits, refunds, and administrative expenses. Investment income and losses during the period are also presented showing income from investing and securities lending activities.

2) Notes to the Financial Statements

The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in TRF's financial statements.

3) Required Supplementary Information

The required supplementary information consists of a Schedule of Funding Progress and a Schedule of Employer Contributions and related notes concerning the funding status of TRF.

FINANCIAL ANALYSIS

Total assets of TRF were \$9.0 billion as of June 30, 2004 compared with \$7.2 billion as of June 30, 2003. The increase in total assets was primarily due to an increase in the market value of investments an increase in receivables from investments sold, and an increase in Securities Lending Collateral held on June 30, 2004.

Total liabilities of were \$2.2 billion as of June 30, 2004 compared with \$1.0 billion as of June 30, 2003. The increase in total liabilities was due to a increase in investments purchased at year end that did not settle until the next fiscal year and an increase in Securities Lending Collateral held on June 30, 2004.

A summary of TRF's Net Assets is presented below:

NET ASSETS

(\$ in thousands)

	June 30, 2004	June 30, 2003	% Change
Assets			
Cash and Cash Equivalents	\$511,385	\$813,084	(37.11%)
Securities Lending Collateral	1,186,186	780,207	52.0%
Receivables	793,345	155,276	410.93%
Investments	6,450,614	5,431,837	18.8%
Other Assets	79	88	(10.2%)
Total Assets	8,941,609	7,180,492	24.5%
Liabilities			
Securities Lending Collateral	1,186,186	780,207	52.0%
Other Current Liabilities	1,001,007	252,106	297.1%
Long-Term Liabilities	125	152	(17.8%)
Total Liabilities	2,187,318	1,032,465	111.9%
Total Net Assets	\$6,754,291	\$6,148,027	9.9%

As the above table shows, plan net assets were \$6.8 billion as of June 30, 2004 a increase of \$606 million, or 9.9%, compared to the prior year, driven by the increase in market value of investments during the year.

The following table presents TRF's investment allocation compared to TRF's target investment allocation and the prior year allocation.

	June 30,2004	June 30, 2004	June 30,2003
	Actual	Target	Actual
Fixed Income	19.3%	25.0%	42.7%
Large Cap Equity	49.2%	32.0%	30.8%
Mid Cap Equity	4.6%	5.0%	4.0%
Small Cap Equity	7.5%	5.0%	8.1%
International Equity	18.6%	18.0%	13.9%
Hedge Funds	0.0%	5.0%	0.0%
Private Equity	0.8%	5.0%	0.5%
Real Estate	0.0%	5.0%	0.0%
Total	100%	100%	100%

The change in weightings between asset classes was driven by a change in TRF's target investment allocation. Funds will be invested, from Large Cap Equity into Real Estate and Hedge Funds as suitable investments are selected. Also remaining Private Equity target allocation of 4.2% will be drawn from the Large Cap Equity investments as suitable investment in this asset class are selected.

A summary of the changes in net assets during the years ended June 30, 2004 and 2003 is presented below:

CHANGES IN NET ASSETS

(\$ in thousands)

	FY Ended June 30, 2004	FY Ended June 30, 2003	% Change
Additions			
Member Contributions	\$115,833	\$109,500	5.8%
Employer Contributions	408,180	575,066	(29.0%)
Contributions to Pension Stabilization Fund:			
From State Lottery	30,000	30,000	0.0
Net Investment (Loss) Income	723,094	344,777	109.7%
Transfers from Public Employees' Fund	2,781	3,847	(27.7%)
Other	1,424	1,354	5.2%
Total Additions	1,281,312	1,064,544	20.4
Deductions			
Benefits	655,330	615,973	6.4%
Refunds	9,704	7,397	31.2%
Transfers to Public Employees' Fund	2,364	1,774	33.3%
Capital Projects	2,600	3,298	(21.2%)
Administrative Expenses	5,028	3,379	48.8%
Claims on Outdated Benefit Checks	22	(51)	(143.1%)
Total Deductions	675,048	631,770	6.9%
Increase (Decrease) in Net Assets	\$606,264	\$432,774	40.1%

ADDITIONS

Additions needed to fund benefits are accumulated through contributions from members and employers and returns on invested funds. Member contributions for the year ended June 30, 2004 totaled \$115.8 million. This represents an increase of \$6.3 million or 5.8% compared to the prior year. Employer contributions were \$408.2 million, a decrease of \$166.8 million or 29.0%. The decrease was due to smaller appropriations made by the State of Indiana.

TRF recognized net investment income of \$723.1 million for the year ended June 30, 2004 compared to net investment income of \$344.7 million in the prior year. The higher investment income was primarily due to the strong equity markets during the first six months of the fiscal year. TRF's domestic large cap equity investments returned a gain 19.07% for the fiscal year. This compares to a gain of 19.11% for the S&P 500 index during the year. Domestic Mid Cap equities had a gain of 27.65% as compared to a gain of 27.98% for the S & P 400 Mid Cap index during the fiscal year. Domestic Small Cap equities had a gain of 30.32%, as compared to a gain of 31.55% for the Russell 2000 index during the fiscal year. International equities had a gain of 26.80%, as compared to a gain of 32.37% for the EAFE index during the fiscal year. Investment gains on equities were supplemented by TRF's fixed income portfolio, which achieved a total return of 1.80% for the year ended June 30, 2004. This compares to a gain of 0.32% for the Lehman's Brothers Aggregate Index. The total rate of return on TRF's investments was a positive 11.82% compared to a positive 6.17% in the prior year.

DEDUCTIONS

The deductions from TRF's net assets held in trust for pension benefits include primarily retirement, disability, and survivor benefits, refunds of contributions to former members, and administrative expenses. For the year ended June 30, 2004, benefits amounted to \$655.3 million, an increase of \$39.4 million or 6.4% from the prior year. The increase in benefits was due to an increase both in the number of retirees and the average benefit paid. Refunds to former members were \$9.7 million, which represents an increase of 31.2% over the prior year.

Administrative expenses were \$5.0 million, an increase of \$1.6 million compared to the prior year. The fiscal year ending June 30, 2003 amount includes a reduction of 1.5 million for data processing system development that was originally expensed as a capital project.

HISTORICAL TRENDS

A pension fund is well funded when it has enough money in reserve to meet all expected future obligations to participants. The funded ratios of the defined benefit pension plans administered by TRF as of the latest actual valuations were as follows:

	July 1, 2003	July 1, 2002
Pre -96 Plan (Closed Plan)	42.9%	41.2%
96 Plan (New Plan)	59.3%	53.2%

An analysis of the funding progress, employer contributions, and a discussion of actuarial assumptions and methods is set forth in the required supplementary information section of the financial statements.

INDIANA STATE TEACHERS' RETIREMENT FUND
STATEMENT OF FIDUCIARY NET ASSETS
June 30, 2004

Assets

Cash and Cash Equivalents	\$ 511,385,212
Securities Lending Collateral	1,186,186,105
Receivables	
Employer Contributions	23,598,251
Due From PERF	10,260,559
Member Contributions	28,672,912
Securities Sold	701,985,537
Investments Interest	28,828,151
Total Receivables	793,345,409
Investments	
U.S. Treasury and Agency Obligations	996,666,315
Corporate Bonds and Notes	899,076,609
Foreign Bonds	28,801,048
Equity Securities	2,727,287,833
Foreign Equity Securities	777,892,959
Mortgage Securities	766,269,815
Venture Capital & Partnerships	31,582,464
State & Municipal Securities	2,264,701
Debt Securities	220,012,007
Indiana Pension Systems, Inc	500,000
Real Estate	260,000
Total Investments	6,450,613,751
Furniture and Equipment (Original Cost of \$487,343 Net of \$408,309 Accumulated Depreciation)	79,034
Insurance Premium Paid in Advance	27
Total Assets	8,941,609,538

Liabilities

Accrued Benefits Payable	-
Accrued Salaries Payable (See Note 1)	88,841
Accrued Liability for Compensated Absences - Current	172,046
Accounts Payable	2,877,956
Due To PERF	7,447,627
Securities Lending Collateral	1,186,186,105
Payables for Securities Purchased	990,420,824
Total Current Liabilities	2,187,193,399
Accrued Liability for Compensated Absences - Long-Term	124,585
Total Liabilities	2,187,317,985
Net Assets Held in Trust for Pension Benefits (See Schedule of Funding Progress, Page 20)	\$ 6,754,291,554

The accompanying notes are an integral part of the financial statements.

INDIANA STATE TEACHERS' RETIREMENT FUND
STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS
Year Ended June 30, 2003

Additions	
Contributions	
Member Contributions	\$ 115,832,926
Employer Contributions	408,180,343
Employer Contributions - Pension Stabilization	<u>30,000,000</u>
Total Contributions	<u>554,013,268</u>
Investments	
Net Appreciation (Depreciation) in Fair Value	547,774,850
Interest Income	135,319,501
Dividend Income	49,988,443
Securities Lending Income	12,566,565
Less Investment Expense	
Investment Fees	(12,538,435)
Securities Lending Fees	<u>(10,016,828)</u>
Net Investment Income	<u>723,094,096</u>
Other Additions	
Transfers From Other Retirement Funds	2,781,420
Annuity and Disability Refunds	1,421,570
Outdated Benefit Checks	-
Reimbursement of Administrative Expense	<u>1,630</u>
Total Other Additions	<u>4,204,619</u>
Total Additions	<u>1,281,311,984</u>
Deductions	
Annuity and Disability Benefits	655,329,910
Voluntary and Death Withdrawals	9,703,864
Claims on Outdated Benefit Checks	22,006
Administrative Expenses	5,001,915
Capital Projects	2,600,245
Depreciation Expenses	25,622
Transfers to Other Retirement Funds	<u>2,363,876</u>
Total Deductions	<u>675,047,438</u>
Change in Net Assets Held in Trust for Pension Benefits	606,264,546
Net Assets Beginning of Year	<u>6,148,027,008</u>
Net Assets End of Year	<u><u>\$ 6,754,291,554</u></u>

The accompanying notes are an integral part of the financial statements.

INDIANA STATE TEACHERS' RETIREMENT FUND
NOTES TO FINANCIAL STATEMENTS
June 30, 2004

Note 1. Summary of Significant Accounting Policies

- A. Reporting Entity - The financial statements presented in this report represent only those funds for which the Indiana State Teachers' Retirement Fund (TRF) has responsibility and are not intended to present the financial position or results of operations of the State of Indiana or all of the retirement and benefit plans administered by the State. Effective July 1, 2001, (Public Law 119-2000), TRF was no longer a department or agency of the State, but became an independent body corporate and politic exercising essential government functions. The members of the Board of Trustees of the Indiana State Teachers' Retirement Fund are appointed by the Governor of the State of Indiana and a financial benefit/burden relationship exists between TRF and the State of Indiana. For these reasons, TRF is considered a component unit of the State of Indiana for financial statement reporting purposes.
- B. Basis of Presentation - The financial statements of the Indiana State Teachers' Retirement Fund have been prepared using fund accounting in conformity with generally accepted accounting principles (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standards setting body for established governmental accounting and financial reporting principles. GASB Statement 25 has been implemented for the defined benefit pension plans.
- C. Fund Accounting - Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain governmental functions or activities. The Indiana State Teachers' Retirement Fund is a pension trust fund. For a description of this fund, see Note 2.
- D. Basis of Accounting - The records of this Fund are maintained on a cash basis. The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.
- E. Budgets - A budget for the administrative expenses is prepared and approved by the Board of Trustees.
- F. Cash and Cash Equivalents - Cash and Cash Equivalents are defined as short-term highly liquid investments that are both:
1. Readily convertible to known amounts of cash.
 2. So near their maturity that they present insignificant risk of changes in value because of changes in interest rates.

Generally, only investments with original maturities of three months or less meet this definition.

INDIANA STATE TEACHERS' RETIREMENT FUND
NOTES TO FINANCIAL STATEMENTS
June 30, 2004
(Continued)

- G. Deposits and Investments - The Treasurer of State acts as the official custodian of the cash and securities, except for securities held by banks or trust companies under custodial agreements with the Board of Trustees. The Board of Trustees may contract with investment counsel, trust companies, or banks to assist the Board in its investment program. The Board is required to diversify investments in accordance with prudent investment standards. The Board has issued investment guidelines for its investment program which authorized investments of U.S. Treasury and Agency obligations, U.S. Government securities, common stock, international equity, corporate bonds, notes and debentures, repurchase agreements secured by U.S. Treasury obligations, mortgage securities, commercial paper, and banker's acceptances. See Note 4 for more details.
- H. Method Used to Value Investments - GASB 25 requires that investments of defined benefit plans be reported at fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Mortgages are valued on the basis of future principal and interest payments, and are discounted at prevailing interest rates for similar instruments. Investments that do not have an established market are reported at estimated fair value.
- I. Equipment - Equipment with a cost of \$5,000 or more is capitalized at the historical cost. Depreciation is computed on the straight-line method over the estimated five-year life of all assets.
- J. Contributions Receivable - The contributions receivable was determined by using actual contributions received in July for days paid in the quarter ended June 30, 2004.
- K. Inventories - Inventories of consumable supplies are not recognized on the balance sheet as they are considered immaterial. Purchases of consumable supplies are recognized as expenditures at the time of purchase.
- L. Payables and Liabilities - Payables and liabilities are not maintained throughout the year on the accounting records. They are calculated or estimated for financial statement reporting purposes and are posted to the general ledger at year end.
- M. Compensated Absences - TRF's full-time employees are permitted to accumulate earned but unused vacation and sick pay benefits. Vacation leave accumulates at the rate of one day per month and sick leave at the rate of one day every two months plus an extra day every four months. Bonus vacation days are awarded upon completion of five, ten and twenty years of employment with the State of Indiana. Personal leave days are earned at the rate of one day every four months; any personal leave accumulated in excess of three days automatically becomes part of the sick leave balance. Upon separation from service, employees in good standing will be paid for a maximum of thirty unused vacation leave days.

No liability is reported for unpaid accumulated sick leave. Vacation and personal leave and the salary-related payments that are expected to be liquidated are reported as Compensated Absences Liability.

INDIANA STATE TEACHERS' RETIREMENT FUND
NOTES TO FINANCIAL STATEMENTS
June 30, 2004
(Continued)

Note 2. Fund Description

The Indiana State Teachers' Retirement Fund is the administrator of a multiple-employer retirement fund established to provide pension benefits for persons who are engaged in teaching or in the supervision of teaching in the public schools of the state or persons who are employed by the fund. At June 30, 2004, the number of participating school unit employers was:

Public School Units	336
Higher Education Units	4
State of Indiana Agencies	30
Associations	<u>2</u>
Total	<u>372</u>

Membership in TRF is required for all legally qualified and regularly employed teachers who serve in the public schools of Indiana, including the faculty at Vincennes University, and employees of TRF. Additionally, faculty members at Ball State University, Indiana State University, and University of Southern Indiana have the option of selecting membership in the Fund or the alternate University Plan. As of July 1, 2003, Indiana State Teachers' Retirement Fund membership consisted of:

Retirees and Beneficiaries

Currently Receiving Benefits	36,235
Active Plan Members	73,641
Terminated Plan Members Entitled to But Not Yet Receiving Benefits	<u>5,283</u>
Total	<u>115,159</u>

The Indiana State Teachers' Retirement Fund provides retirement benefits, as well as death and disability benefits. Eligibility to retire occurs at age fifty with fifteen or more years of service or at age sixty-five with ten years of service. Annual retirement benefits, disability benefits, and death benefits are computed as follows:

Regular Retirement (No Reduction Factor For Age)

Eligibility - Age sixty-five with ten years service or age sixty with at least fifteen years of service or age fifty-five with age plus years of service equaling at least eighty-five.

Mandatory Retirement Age - none.

Annual Amount - State pension equal to total years of service times 1.1% of final average salary; plus an annuity purchased by the member's accumulated contributions unless the member elects to withdraw the accumulated contributions in a lump sum.

Type of Final Average Salary - Average of highest five years.

INDIANA STATE TEACHERS' RETIREMENT FUND
NOTES TO FINANCIAL STATEMENTS
June 30, 2004
(Continued)

Early Retirement (Age Reduction Factor Used)

Eligibility - Age fifty with fifteen or more years service.

Annual Amount - State pension is computed as regular retirement benefit but reduced one-tenth of 1% for each month age at retirement is between sixty and sixty-five and five-twelfths of 1% for each month under age sixty.

Deferred Retirement (Vested Benefit)

Eligibility - Ten years of service. Benefit commences at age sixty-five, or at age fifty if member has fifteen or more years of service.

Annual Amount - Computed as a regular retirement benefit with state pension based on service and final average salary at termination.

Regular Disability

Eligibility - Five years of service.

Annual Amount - \$125 per month plus \$5 for each year of service credit over five years.

Disability Retirement (No Reduction Factor For Age)

Eligibility - Five years of service and also qualify for Social Security Disability at time of termination.

Annual Amount - Computed as a regular retirement benefit with state pension based on service and final average salary at termination.

Duty Death Before Retirement

Eligibility - Fifteen years of service. Spouse to whom member had been married for two or more years is automatically eligible, or a dependent may be designated as beneficiary.

Annual Amount - Computed as regular retirement benefit but reduced in accordance with a 100% joint and survivor election.

Benefit Increases After Retirement: No automatic increases after retirement are provided. Unscheduled increases have been made from time to time.

Each member shall, as a condition of employment, contribute to the Fund 3% of his/her compensation. Effective July 1, 1986, each employing unit may elect to "pick up" the employee contribution. No part of the member contributions to the Fund picked up by the employer is includable in the gross income of the member. The "pick up" amount does count in the salaries used to determine the final average at retirement. Any member who leaves covered employment has the option to withdraw accumulated contributions and interest. In the event of a death of a member who has served less than fifteen years or does not meet the surviving spouse requirements, his/her designated beneficiary or estate is entitled to a lump sum settlement of their contributions plus interest.

INDIANA STATE TEACHERS' RETIREMENT FUND
NOTES TO FINANCIAL STATEMENTS
June 30, 2004
(Continued)

Indiana pension statutes stipulates that each member of TRF shall have the opportunity to direct his/her annuity savings account into one of five current investment programs:

1. The Guaranteed Fund - Interest is credited at a rate annually determined by the Board of Trustees. Principal and interest are "guaranteed." Market risk is assumed by TRF.
2. The Bond Fund - Contains high quality fixed-income instruments which provide interest/capital gain income. Market risk is assumed by the member.
3. S & P 500 Index Fund - Closely tracks the return on the S & P 500 Index by employing an indexing strategy that invest in the stocks of the S & P 500 Index companies. Market risk is assumed by the member.
4. Small Cap Equity Fund - Consist of stocks with a market capitalization of less than \$1.5 billion. Market risk is assumed by the member.
5. International Equity Fund - Consists of securities of developed non-U.S. countries. Market risk is assumed by the member.

The Guaranteed Fund, Bond Fund, S & P 500 Index Fund, Small Cap Fund and International Fund are valued at market value. When a member retires, dies or suspends membership and withdraws from the fund, the amount credited to the member shall be valued at the market value of the member's investment plus accrued interest on investment less accrued investment expenses.

Members may only make a selection or re-allocation once per quarter. The changes will be in effect the first month of the quarter following the request for change. Members may request allocations to one or all of the approved funds, as long as those allocations are made in 10% increments of the total balance in the member's account at the time of allocation. The total must equal 100%.

Note 3. Employer Contributions Required and Employer Contributions Made

The Indiana State Teachers' Retirement Fund is funded on a "pay as you go" basis for employees hired prior to July 1, 1995. State appropriations are made for the amount of estimated pension benefit payout for each fiscal year. For employees hired on or after July 1, 1995, the individual employer will make annual contributions. These contributions are actuarially determined.

Based on the actuarial valuation at June 30, 2003, employer actuarially required contributions were \$619,186,005 of normal cost, with no amortization of the unfunded actuarial accrued liability and zero provision for expenses. Contributions made by employers for the year ended June 30, 2004, totaled \$438,180,343 which was 12% of covered payroll.

Note 4. Deposits, Investments and Securities Lending

Investments made by the Indiana State Teachers' Retirement Fund, including repurchase agreements, are summarized below. The investments that are represented by specific identifiable investment securities are classified as to credit risk by the three categories described below:

INDIANA STATE TEACHERS' RETIREMENT FUND
NOTES TO FINANCIAL STATEMENTS
June 30, 2004
(Continued)

Category 1 includes investments that are insured or registered or for which securities are held by TRF or its agent in TRF's name. Category 2 includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or its agency in TRF's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent but not in TRF's name.

State statutes and Board of Trustees permit TRF to lend securities to broker-dealers and other entities (borrowers) for collateral that will be returned for the same securities in the future. TRF's custodial bank manages the securities lending program and receives securities or cash as collateral. The collateral securities cannot be pledged or sold by TRF unless the borrower defaults, but cash collateral may be invested by TRF. Collateral securities and cash are initially pledged at 102% of the market value of the securities lent. No more than 40% of TRF's total assets may be lent at any one time. At year-end, TRF has no credit risk exposure to borrowers because the amount TRF owes the borrowers exceed the amounts the borrowers owe TRF.

Approximately 25% of the securities loans can be terminated on demand either by TRF or by the borrower, although generally the average term of these loans is one day. Cash collateral is generally invested in securities of a longer term, generally with maturities up to one year, and the weighted-average term to maturity of all collateral investments was thirty days.

		<u>Category</u>		
	<u>1</u>	<u>2</u>	<u>3</u>	<u>Market Value</u>
U.S. Equity Securities				
Not on Securities Loan	\$2,407,741,809	\$ -	\$ -	\$2,407,741,809
On Securities Loan	-	16,609,608	-	16,609,608
Foreign Equity Securities				
Not on Securities Loan	642,725,504	-	-	642,725,504
On Securities Loan	-	9,509,469	-	9,509,469
Corporate Bonds				
Not on Securities Loan	809,063,975	-	-	809,063,975
On Securities Loan	-	-	-	-
Foreign Bonds	28,801,048	-	-	28,801,048
U.S. Treasury & Agency Obligations				
Not on Securities Loan	256,423,545	-	-	256,423,545
On Securities Loan	-	98,921,558	-	98,921,558
Mortgage Securities	766,269,815	-	-	766,269,815
Debt Securities	220,012,007	-	-	220,012,007
State & Municipal Securities	<u>2,264,701</u>	<u>-</u>	<u>-</u>	<u>2,264,701</u>
 Total Investments Categorized	 <u>\$ 5,133,302,404</u>	 <u>\$ 125,040,635</u>	 <u>\$ -</u>	 <u>\$ 5,258,343,040</u>

INDIANA STATE TEACHERS' RETIREMENT FUND
NOTES TO FINANCIAL STATEMENTS
June 30, 2004
(Continued)

U.S. Treasury & Agency Obligations	\$ 641,321,212
U.S. Equity Securities	302,936,416
Foreign Equity Securities	125,657,985
Corporate Bonds	<u>90,012,634</u>
 Total	 <u>1,159,928,247</u>
 Investments held by broker-dealers under securities lending short-term cash collateral investment pool.	
	1,186,186,105
Other	
Venture Capital & Partnerships	31,582,464
Real Estate	260,000
Membership in Non-Profit Corp.	<u>500,000</u>
 Total Investments Not Categorized	 <u>\$ 2,378,456,816</u>

Note 5. Deferred Compensation Plan

The State offers its employees a deferred compensation plan (the plan) created in accordance with Internal Revenue Code Section 457. The plan, available to all State employees and employees of certain quasi-agencies and political subdivisions within the State, permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

All amounts of compensation deferred under the plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights are (until paid or made available to the employee or other beneficiary) held for the exclusive benefit of participants of the plan and their beneficiaries as required by section 457(g) of the Internal Revenue Code. In addition, the State has an Indiana Incentive Match Plan which provides \$15 per pay period for each employee who contributes to the 457 Plan.

The State has established a deferred compensation committee that holds the fiduciary responsibility for the plan. The committee holds the deferred amounts in an expendable trust.

Note 6. Contingent Liabilities

The Indiana State Teachers' Retirement Fund has no contingent liabilities. Tort claims are paid from the General Fund of the State of Indiana through the Attorney General's Office and are not paid by the Fund.

INDIANA STATE TEACHERS' RETIREMENT FUND
NOTES TO FINANCIAL STATEMENTS
June 30, 2004
(Continued)

Note 7. Risk Management

TRF is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; job related illnesses or injuries to employees; and natural disasters.

The general policy of TRF is not to purchase commercial insurance for the risks of loss to which it is exposed. The Fund does purchase a limited amount of insurance for malfeasance and theft by means of a Special Bond for the Board of Trustees and the Executive Director. TRF also has purchased a General Bond for its other employees. The Fund's healthcare, worker's compensation and unemployment compensation programs are administered in the same manner as that of agencies of the State of Indiana.

Note 8. Employee Fund Membership

Employees of the Indiana State Teachers' Retirement Fund are now eligible for membership in TRF. Effective July 1, 2001, IC 21-6.1-4-1(a)-(10) states that members of TRF include persons who are employed by TRF.

Note 9. Reserves and Designations

The following are the legally required reserves and other designations of fund equity:

1. Member Reserve: These member's reserve represents member contributions made by, or on the behalf of, the employees plus any interest distributions, less amounts refunded or transferred to the Benefits in Force reserve for retirement disability, or other benefit. For Indiana State Teachers' Retirement Fund this reserve is the employees' annuity savings account.
2. Benefits in Force: This reserve represents the actuarially present value of future benefits for all members who are presently retired or disabled. The accumulated contributions of the members are transferred to the reserve upon retirement or disability. The remainder of the actuarial pension cost is transferred from the employer reserve to fund the benefits. This reserve contains \$1,953,065,682 for the Pension Stabilization Fund. The Pension Stabilization Fund was established by IC 21-6.1-2-8.
3. Employer Reserves: This reserve consists of the accumulated employer contributions plus earnings distributions less transfers made to the Benefits in Force reserve of the actuarial pension cost.
4. Undistributed Investment Income Reserve: This reserve was credited with all investment earnings. Interest transfers have been made annually to the other reserves as allowed or required by statutes. The transfers are at rates established by the Board of Trustees.
5. Unreserved Fund Balance: This reserve represents the unfunded actuarial accrued liability for nonretired participants, determined by TRF's actuary, as of the date of the last valuation.

INDIANA STATE TEACHERS' RETIREMENT FUND
NOTES TO FINANCIAL STATEMENTS
June 30, 2004
(Continued)

Note 10. Intergovernmental Transfers with the Public Employees Retirement Fund (PERF)

Transfers of a member's reserves are made between TRF and PERF when, at the time of retirement, a member has service that is covered by both funds. Service covered by PERF and the related Annuity Savings Account balance will be used by TRF at the time of retirement in calculating the member's retirement benefit from TRF if the member was last employed in a TRF covered position. If the member was last employed in a PERF covered position, PERF will use the member's TRF service and Annuity Savings Account balance. At the time the retirement is calculated, TRF sets up a receivable from PERF for both the Annuity Savings Account balance and the calculated reserve for the service credit brought in from PERF. This receivable is included as a line item in the "Receivables" section of TRF's Statement of Fiduciary Net Assets. On the reverse side, TRF recognizes a payable in the Liabilities section of the Statement of Fiduciary Net Assets for TRF amounts used in calculating a PERF retiree's benefit.

Note 11. Membership in Non-Profit Corporation

TRF is a member with PERF in Indiana Pension Systems, Inc (IPSI). IPSI is a tax-exempt nonprofit corporation created to provide information technology services to TRF and PERF. IPSI is governed by a five-member board composed of two TRF appointees, two PERF appointees, and one appointee appointed by either PERF or TRF on a rotating basis. The current board is composed of two TRF appointees and three PERF appointees. The board members serve two-year terms. Once the current rotating director's term expires, TRF will appoint the new director. PERF and TRF each contributed \$500,000 in start-up assistance to IPSI. Upon dissolution of IPSI, the net assets will be distributed equally to TRF and PERF. As of June 30, 2004, IPSI's net assets were \$1,000,000. All IPSI expenditures are paid by IPSI and then billed periodically to TRF and PERF. Because IPSI's only clients are TRF and PERF, and all expenditures made by IPSI are billed to TRF and PERF, IPSI is not expected to have any net operating income for any financial reporting period.

INDIANA STATE TEACHERS' RETIREMENT FUND
REQUIRED SUPPLEMENTAL SCHEDULES
June 30, 2004

SCHEDULE OF FUNDING PROGRESS

(Dollar Amounts in Millions)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ration (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
06-30-98	\$ 4,266	\$ 11,779	\$ 7,513	36.22%	\$ 3,095	242.75%
06-30-99	4,971	12,671	7,700	39.23%	3,294	233.76%
06-30-00	5,578	13,115	7,537	42.53%	3,193	236.05%
06-30-01	5,811	13,524	7,713	42.97%	3,319	232.39%
06-30-02	6,176	14,665	8,489	42.11%	3,609	235.22%
06-30-03	6,554	14,747	8,193	44.44%	3,585	228.54%

SCHEDULE OF CONTRIBUTIONS FROM THE EMPLOYERS
AND OTHER CONTRIBUTING ENTITIES

Fiscal Year	Valuation Date June 30	Annual Required Contribution	Percentage Contributed
1998-1999	06-30-97	\$ 508,259,679	122%
1999-2000	06-30-98	524,815,537	123%
2000-2001	06-30-99	547,532,673	126%
2001-2002	06-30-00	537,789,669	106%
2002-2003	06-30-01	572,226,197	106%
2003-2004	06-30-02	638,541,074	69%

INDIANA STATE TEACHERS' RETIREMENT FUND
REQUIRED SUPPLEMENTAL SCHEDULES
June 30, 2004

NOTES TO REQUIRED SUPPLEMENTAL SCHEDULES

The information presented in the required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information as of the latest actuarial valuation follows:

Valuation Date	June 30, 2003
Actuarial Cost Method	Entry Age Actuarial Cost Method
Amortization Method	Level Percent of Pay Closed
Remaining Amortization Period	36 Years
Asset Valuation Method	4-year Smoothed Market Value with Corridor
Actuarial Assumptions:	
Investment Rate of Return	7.50%
Projected Salary Increases*	4.5%-15.5%
*Includes Wage Inflation at	4.50%
Cost of Living Adjustments	Unscheduled, Periodic Increases

TEACHERS' RETIREMENT FUND
AUDIT RESULTS AND COMMENTS
June 30, 2004

DOCUMENT RETENTION

Several imaged documents in retired member files selected for audit were missing or illegible. The member files are destroyed after all documents in the file are imaged. The Teachers' Retirement Fund document retention allows for destroying the member file, but only after the imaged file has been reviewed for completeness and legibility.

Documents should be retained in accordance with a retention schedule approved by the Oversight Commission on Public Records. Also, documents must be filed in such a manner as to be readily retrievable or otherwise reasonably attainable, upon request, during an audit.

MEMBER RESERVE RECONCILIATION

The reconciliation of the member reserves as of June 30, 2004, had an unidentified variance between the subsidiary computer system record (SIRIS) and the general ledger balance. The SIRIS balance for member reserves was \$18,533,831 greater than the general ledger balance, an amount which was material to the fund. The cause of the variance is not known.

Prior to this audit a reconciliation between the SIRIS and the general ledger balance had not been performed. Through review we have determined that a variation has existed prior to this audit. However, we were not able to determine when the variation began.

A critical system conversion began March 2001 in which the SIRIS system was implemented. Documentation of the conversion process, including verification of the transfer of appropriate balances, was not available for audit. Documentation to determine if a variance existed before the conversion was also not available for audit. It has also been determined that a changing variation has existed since the conversion.

The lack of available documentation has also made it difficult to ascertain the cause of the variation. In addition, we noted during the audit testing for the Teachers' Retirement Fund (TRF) that the SIRIS computer system does not provide detailed transaction reports to support or identify the composition of grand totals reported. This results in the lack of an audit trail, which is considered an internal control weakness. This lack of an audit trail further hampers the identification of the cause of the variance.

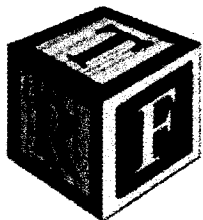
Indiana Code 21-6.1-3-6.1 provides that:

"The board shall annually analyze for internal control purposes the fund's;

- (1) income and expenditures;
- (2) actuarial condition;
- (3) reserve accounts;
- (4) investments; and
- (5) such other data as necessary to interpret the fund's condition and the board's administration of the fund."

INDIANA STATE TEACHERS' RETIREMENT FUND
EXIT CONFERENCE

The contents of this report were discussed on March 3, 2005, with Dr. William Christopher, Director. The official response to the audit findings has been made a part of this report and may be found on page 24 through 26.



Indiana State Teachers' Retirement Fund

150 West Market Street, Suite 300
Indianapolis, IN 46204-2809

Telephone: (317) 232-3860
Toll-Free: (888) 286-3544
FAX: (317) 232-3882
TTD: (317) 233-3306

Web Page: www.in.gov/trf
E-mail: trf@trf.in.gov

OFFICIAL RESPONSE

State Board of Accounts
302 West Washington Street
Room E 418
Indianapolis, IN 46204-2738

Ladies and Gentlemen:

We have received the State Board of Accounts Audit Results and Comments. For many years, the Indiana State Teachers' Retirement Fund has viewed the annual audit as a way to improve our management of the Fund. More importantly, the Fund has considered the State Board of Accounts as a partner in providing good government and service to the members of the Retirement Fund and the citizens of Indiana. With this in mind, we have constructed this response to the State Board of Accounts Audit Results and Comments.

DOCUMENT RETENTION

Documentation is at the heart of the management of the Indiana State Teachers' Retirement Fund. Over the past two years, we have worked diligently to provide an appropriate record of documents supporting the transactions of the Fund. Our system entails a new imaging process that is backed up with microfilming of each document and file. The microfilming process takes place after the initial imaging operation and provides copies of all documents to the Fund on microfilm and a master copy to the Indiana State Archives. We have experienced some delay in the microfilming and have in recent months undertaken microfilming of our documents with a vendor outside of State Government.

In order to correct problems that the State Board of Accounts staff members have reviewed, we have developed a list of files that were reviewed and will provide copies of faulty documents by microfilm. There is a backup process and a document retention schedule that is reviewed periodically to make sure Retirement Fund records and documentation meet the standards we need for effective operation of the Fund.

We will continue to monitor our records operations and make changes that support the needs of the Fund and the State Board of Accounts.

MEMBER RESERVE RECONCILIATION

The operating system for TRF and PERF is known as the State of Indiana Retirement Information System (SIRIS). Over a period of five years, the system has been under development and is now appreciably complete. The result is a complicated system specific to the TRF and PERF retirement process and their data information storage. It is capable of very complex and minute information inquiries. Unfortunately, it also requires understanding and training in order to effectuate inquiries and gain reports. TRF continues to train our staff and to learn of the tremendous capabilities of the system.

For over two years, TRF operated a parallel system, using the legacy system and SIRIS. In the long run this was a prudent decision, but ultimately it built inequities because of timing and continual upgrading and change in the new system. SIRIS is capable of much more than we have learned to date.

The SIRIS system provides a report to indicate the combined balance of all member accounts, broken down by contributions and earnings. A portion of the report reflects a summary of the various transaction types to substantiate the daily change in combined balances. The reporting in the initial periods of the utilization of SIRIS was less than adequate. The reporting process has been enhanced since June 2003. Since that time, the transactions in all cases justify the daily change in the member balances.

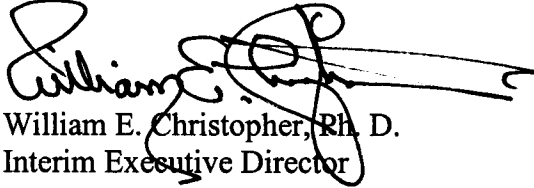
Currently, programmers are providing additional enhanced reports that identify individual transactions to support the daily summary reports. These transaction summaries are the source of general ledger entries. We are using these reports to work backwards from June 2003 to determine the timing and source of the discrepancies. The effort of the programmers has already provided an explanation of some of the variances included in the total discrepancy; the effort continues in order to complete the reconciliation. We believe this effort will identify timing issues resulting from the running of two computer systems during 2001 and 2002.

Understanding that TRF's partnership with the State Board of Accounts may include staff training and the design of special reports to satisfy audit questions; we stand ready to provide such training and to design those reports that will be helpful to the State Board of Accounts.

Page 3
State Board of Accounts
March 11, 2005

The TRF staff and the Board of Trustees take very seriously any concern that is offered by the State Board of Accounts. Collectively, we will work diligently to provide whatever documentation, training, report development or other accommodations necessary or required by the State Board of Accounts. We appreciate the professional attitude of State Board of Accounts Staff and will continue to strive to uphold our traditional partnership.

Sincerely,

A handwritten signature in black ink, appearing to read "William E. Christopher". The signature is stylized with a large, looped initial "W" and a long, horizontal stroke extending to the right.

William E. Christopher, Ph. D.
Interim Executive Director